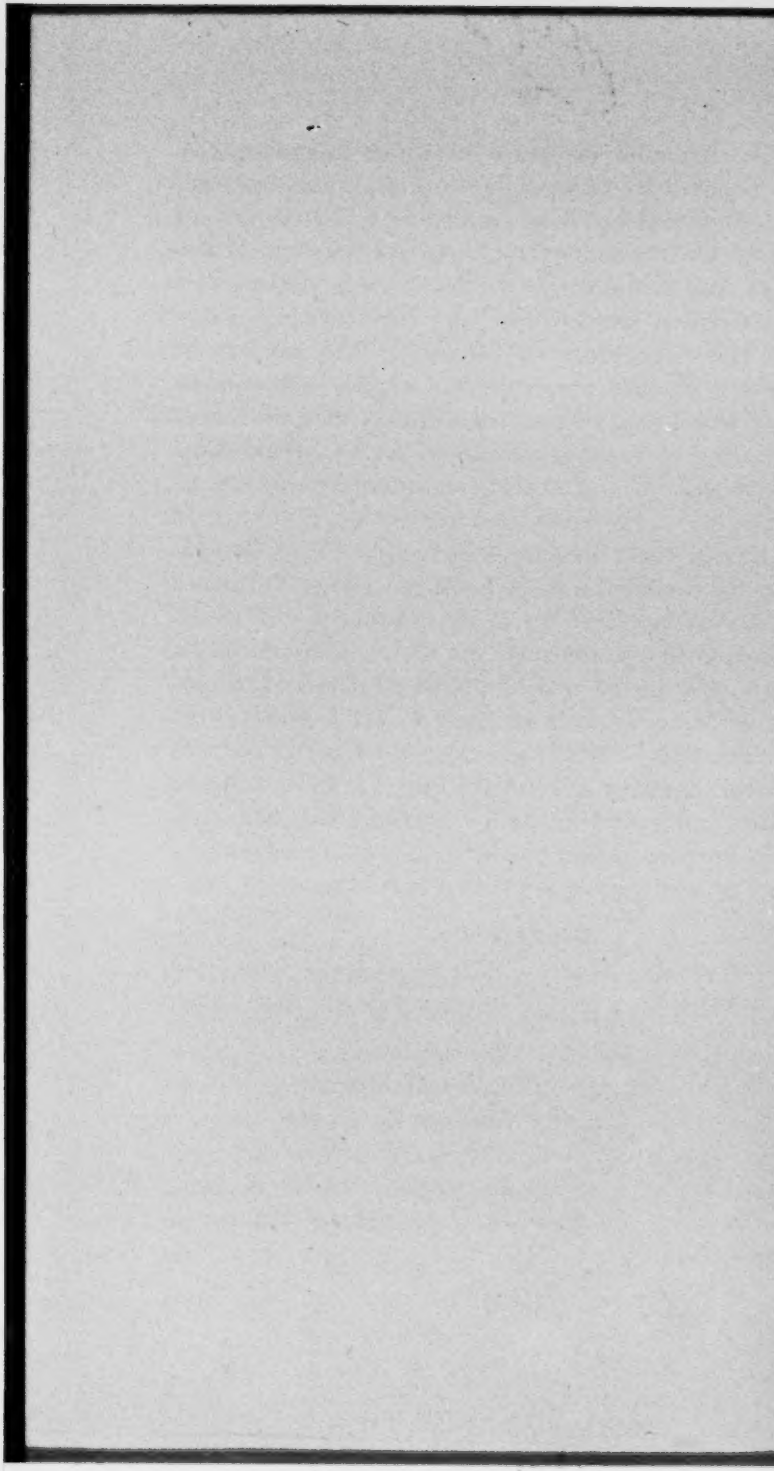


Office - Supreme Court, U. S.
FILED
OCT 30 1942
CHARLES ELMORE CROPLEY

Supreme Court of the United States

OCTOBER TERM, 1942

No. 442

PAUL O. BUCKLEY,
Petitioner,

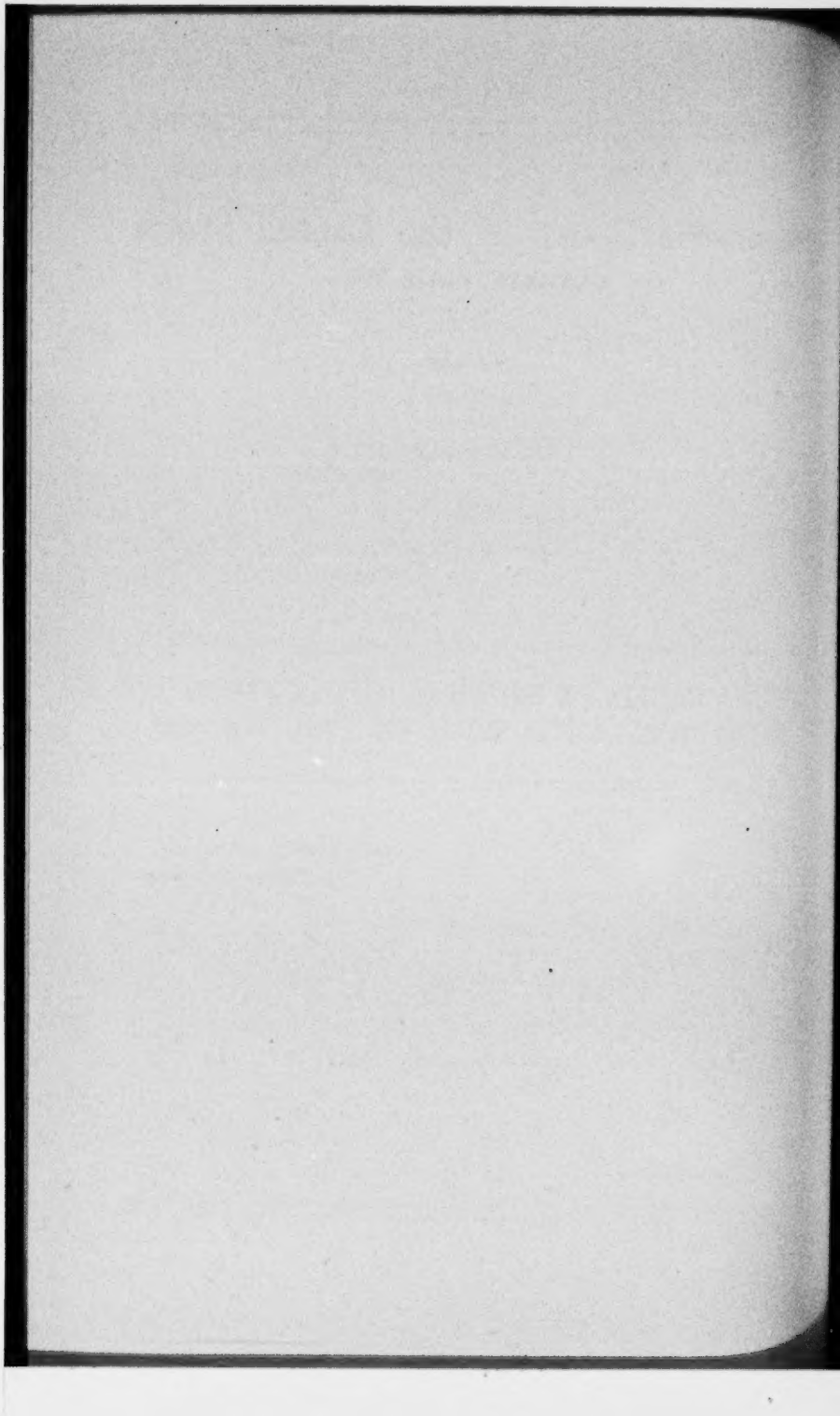
vs.

ROSS W. JUDSON,
Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

ELI WHITNEY DEBEVOISE,
Counsel for Respondent.

DEBEVOISE, STEVENSON, PLIMPTON & PAGE,
D. F. MCGLINCHEY,
Of Counsel.



INDEX

	PAGE
OPINIONS OF COURTS BELOW	1
JURISDICTION	1
QUESTIONS PRESENTED	1
STATEMENT OF THE CASE	3
The Relationship Between the Parties	5
The Bath Transaction	6
SUMMARY OF ARGUMENT	10
ARGUMENT	11
No Question of Federal Law	11
No Participation by Respondent	13
Fiduciary Relationship	15
The Alleged Illegality is Collateral and Remote	18
Petitioner is Not Entitled to Affirmative Relief	19
The Decision of the Circuit Court of Appeals is in Accord With Applicable Law	20
CONCLUSION	22

TABLE OF CASES CITED

Brooks v. *Martin* (1863) 2 Wall. 70	16, 18
Buchhalter v. *Rude* (C. C. A. 10th, 1931) 54 F. (2d) 834; 286 U. S. 451	19

PAGE

Duval v. *Wellman* (1891) 124 N. Y. 156 16

Fidelity & Deposit Co. v. *Grand National Bank of St. Louis* (C. C. A. 8th, 1934) 69 F. (2d) 177 14
Ford v. *Harrington* (1857) 16 N. Y. 285 16
Frost, A. C. & Co. v. *Coeur d'Alene Mines Corp.*, 312 U. S. 38 ..... 11, 20, 21, 22

Hanover National Bank v. *First National Bank* (C. C. A. 8th, 1901) 109 Fed. 421, 426-7 18

Ingersoll v. *Weld* (1905) 103 App. Div. (N. Y.) 554.. 16

Kinsman v. *Parkhurst* (1855) 59 U. S. 289, 293; 18 How. 289, 293 17

Langley v. *Devlin* (1917) 95 Wash. 171 18

Meinhard v. *Salmon* (1928) 249 N. Y. 458 18

Norton v. *Blinn* (1883) 39 Ohio St. 145 16

Pa. R. R. Co. v. *Chamberlain* (1933) 288 U. S. 333, 339 14
Place v. *Hayward* (1889) 117 N. Y. 487 16
Planters' Bank v. *Union Bank* (1872) 16 Wall. 483, 499 ..... 16, 18

State v. *Capital City Bank* (1927) 32 N. M. 369..... 18
Steele v. *Drummond* (1927) 275 U. S. 199 17

Tracy v. *Talmadge* (1856) 14 N. Y. 162 ..... 16, 18
Twin City Co. v. *Harding Glass Co.* (1931) 283 U. S. 353, 356 ..... 17, 22

Van Tine v. *Hilands* (S. D. N. Y. 1904) 131 Fed. 124 17

Wood v. *Rabe* (1884) 96 N. Y. 414 16

STATUTES CITED

PAGE

Judicial Code, §240(a) 1

Securities Act of 1933 (48 Stat. 44, 15 U. S. C. §77(a) et seq. 3, 11, 12, 22

Supreme Court of the United States

OCTOBER TERM, 1942

No. 442

PAUL O. BUCKLEY,
Petitioner,
vs.
ROSS W. JUDSON,
Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

Opinions of Courts Below

The opinion of the District Court is not reported. The opinion of the Circuit Court of Appeals (Judges Augustus N. Hand, Clark and Frank) is reported in 130 F. (2d) 174.

Jurisdiction

The jurisdiction of the lower Federal Courts was based upon diversity of citizenship. Petitioner is attempting to invoke the jurisdiction of this Court under Sec. 240(a) of the Judicial Code, as amended.

Questions Presented

1. Whether a court of equity will refuse to enforce the obligations of a trusted confidential adviser and agent under his agreement to reimburse his principal by delivering to him shares of stock to replace shares sold by the principal

for his account,—the shares in question having formed part of a public offering of stock by others,—upon the ground that the existence of such agreement was not stated in a registration statement, where the agreement between the parties was in itself valid in every respect, and where the principal was not a party to the registration statement and took no part in its preparation and the non-disclosure was not in the contemplation of the principal, and where the confidential adviser and agent actively participated in the negotiations for the marketing of the stock and the preparation of the registration statement, and where the principal relied implicitly upon his advice with respect to the matter in controversy.

2. Whether the trusted confidential adviser and agent can so avoid his obligations, irrespective of the materiality of the omission of mention of such agreements in the registration statement,

(a) Where such agent knowingly misrepresented that "under the laws of the S. E. C." he could not sell any stock registered in his name, and the principal relied upon such statement and the agent's advice that it was necessary to cast the transaction in the form adopted in order to comply with the law, and

(b) Where such agent has received the benefits of the principal's performance, and

(c) Where the principal was not a party to the registration statement, took no part in its preparation and had no knowledge as to whether reference in the registration statement to the existence of the agreement between him and such agent was necessary, and had no knowledge until two months later that such agreement was not mentioned in the registration statement and could realize no advantage from any such omission, and

(d) Where the parties, because of their relationship and conduct, were not in *pari delicto,* and

(e) Where any wrong done is a thing of the past, is collateral to the cause of action asserted and the relation of any illegality to the relief sought is indirect and remote.

3. Whether the trusted confidential adviser and agent can so avoid his obligations, where the agent's title to the stock was never complete, and where the stock which is the subject matter of the suit is in the custody of the court under what in effect is an order of interpleader, so that a refusal by the court to act in favor of the principal would amount to affirmative action in favor of the agent.

The questions advanced by petitioner are not in fact presented. They disregard the opinion of the Circuit Court of Appeals and are framed upon findings of the District Court as to a "secret agreement or arrangement" which are not supported by the record and which the Circuit Court of Appeals in effect reversed. Furthermore, the decision of the Circuit Court of Appeals did not depend upon whether there had been compliance with the Securities Act of 1933 (48 Stat. 44, 15 U. S. C. 77(a), et seq.).

Statement of the Case

This suit was instituted by respondent to secure an accounting from petitioner with reference to numerous transactions between them during the period from 1930 through 1937 and to obtain specific performance of petitioner's agreement with reference to 18,000 shares of stock of Bath Iron Works Corporation (hereinafter called Bath Corporation) and to enforce a lien against petitioner's interest in Bath Corporation stock (R. 8 to 30).*

Respondent was awarded a judgment, upon the accounting which was granted by both the Special Master and the

* References are to pages in the record, unless otherwise indicated. References to exhibits are to complainant's exhibits, unless the letters "D's" are used.

District Court, in the sum of $191,622.95 and respondent's lien was recognized (R. 2568-73). Respondent appealed to the Circuit Court of Appeals from the refusal of the District Court to enforce the agreement with respect to 18,000 shares of Bath Corporation stock, the existence of which had been found by the Master and by the District Court (R. 2469-70, 2491, 2489, 2473-4, 2541). The Circuit Court of Appeals granted enforcement, stating in part:

> "* * * sound public policy will not be promoted by depriving a principal of the right to hold his agent accountable in situations like the present.
>
> Numerous authorities support the view that a suit for recovery is not barred in cases where: (a) the parties, because of their relationship and conduct are not in pari delicto, Ford *v.* Harrington, 16 N. Y. 285; Tracy *v.* Talmadge, 14 N. Y. 162, 67 Am. Dec. 132; Norton *v.* Blinn, 39 Ohio St. 145, 149; Place v. Hayward, 117 N. Y. 487, 23 N. E. 25; 6 Williston, Contracts, Rev. Ed., §1789; (b) where any wrong done is a thing of the past, and is collateral to the cause of action asserted and where the relation of the illegality to the relief sought is indirect and remote, Loughran *v.* Loughran, 292 U. S. 216, 228, 54 S. Ct. 684, 78 L. Ed. 1219; Planters' Bank *v.* Union Bank, 16 Wall. 483, 499, 21 L. Ed. 473; Brooks *v.* Martin, 2 Wall. 70, 17 L. Ed. 732; Hanover Nat. Bank *v.* First Nat. Bank, 8 Cir. 109 F. 421; State *v.* Capital City Bank, 32 N. M. 369, 257 P. 993; (c) where the res sought to be recovered is held in escrow under what is in effect an order of interpleader so that a refusal to act in favor of the complainant will amount to affirmative action in favor of the other party. Buchhalter *v.* Rude, 10 Cir., 54 F. 2d 834, modified as to costs 286 U. S. 451, 52 S. Ct. 605, 76 L. Ed. 1221; Commonwealth Finance Corp. *v.* McHarg, 2 Cir., 282 F. 560; Langley *v.* Devlin, 95 Wash. 171, 163 P. 395, 4 A. L. R. 32.
>
> Each of these three conditions exists here. Moreover, we do not see that any misstatements were made to the Commission in respect to matters which might mislead investors to their damage.
>
> In view of the foregoing, it seems to us that Judson is entitled to a decree ordering the delivery to

him of 18,000 shares of Bath Iron Works stock now standing in the name of Buckley. * * * " (R. 2594-5) 130 F (2d) 174, 180.

The Relationship Between the Parties

Petitioner and respondent became acquainted in the spring of 1930 and petitioner represented himself as being experienced and skilled in matters relating to finances and securities (R. 2462). Petitioner was a lawyer who had given up the practice of law in 1929 "to engage in the securities business and the business of advising others with respect to investments and business ventures" (R. 2461). Respondent was a retired industrialist of considerable means, while petitioner had no capital (R. 2461-2; 1964-5; 885-6). A very close friendship and business relationship was rapidly developed between them and by the end of 1930 they were together practically every day and discussed all of respondent's personal and business affairs (R. 309, 317, 320, 972, 1004, 1098). During the latter part of 1930, petitioner rendered some services to respondent and was paid a fee in one matter (R. 2462) and refused compensation in the other, but suggested that he would be amply compensated and both parties would benefit if respondent would "permit Buckley to manage brokerage accounts for Judson under an arrangement whereby Buckley would receive 25% of the trading profits" (R. 2463). Respondent concurred in petitioner's suggestion, and in January, 1931, opened a brokerage account and entrusted the management thereof to petitioner (R. 2463). Subsequently a series of substantial brokerage accounts were opened with respondent's capital under the same arrangement, and petitioner retained authority to operate all of these accounts as long as they continued in existence—until the latter part of 1937 (R. 2463). The agreement under which the profits from these accounts was to be divided was never reduced to writing, and as a matter of fact, neither of these parties kept any written record of their many dealings together, but relied on their close friendship and relationship to avoid any misunderstandings (R. 2439).

The only written agreement which they ever made between themselves involved their relationship in the transactions in Bath Corporation stock, and this agreement was only reduced to writing at the insistence of accountants long after the original transaction (R. 2473-4, 217-8).

The transactions in respondent's brokerage accounts operated by petitioner were extensive. Some idea of the magnitude of the operations managed by petitioner can be gained from the fact that respondent's losses in the accounts from 1931 through 1937 amounted to more than $600,000 (R. 2463). Under the agreement between them, the petitioner risked no capital and did not have to bear any portion of the loss.

Petitioner had charge of all of respondent's financial affairs and respondent relied upon petitioner to obtain funds from respondent's assets under his control to meet respondent's obligations and he advised people with whom he was dealing that his affairs were in petitioner's hands (D's Ex. 89, R. 2412, 1974; D's Ex. 93, R. 2416, 1976). All of the witnesses who testified concerning the relationship between the parties told of their more or less constant association, (R. 1763, 1818) and one of petitioner's witnesses said that he "considered Buckley Judson's alter ego * * * Any time I talked to Buckley, I figured I was talking to Judson" (R. 1540).

Respondent reposed complete trust and confidence in Buckley and relied upon his advice and depended upon his judgment (R. 292). Respondent signed papers which petitioner presented to him without making any personal examination. He testified "I did not examine what they were. Mr. Buckley told me they were all right and in order, and I just signed them" (R. 211; see also 368, 1978).

The Bath Transaction

In September, 1935, respondent purchased from the receiver of the Harriman National Bank a past due promissory note (of a third person) secured by the pledge of a

majority of the outstanding stock of Bath Corporation. Upon acquisition, the promissory note and pledged stock were delivered to the Collector of Internal Revenue at Detroit to be held subject to the lien of a deficiency assessment against respondent. The pledge was foreclosed in January, 1936, respondent becoming the owner of the pledged stock, which continued to be held by the Collector subject to such lien (R. 2466).

Petitioner and one Harbeck had rendered services to respondent in this transaction, and in March, 1936, respondent paid $10,000 to Harbeck in full settlement for the services rendered by him and at about the same time, at petitioner's suggestion, respondent agreed to give to petitioner 25% of all of the profits from the Bath deal (R. 2467, 2512, 202). Shortly thereafter, at petitioner's suggestion, respondent agreed that instead of 25% of the profits, petitioner should have a 25% interest in the deal, for which petitioner was to pay 25% of all costs and expenses and was also to arrange for marketing the stock, and respondent was "to be under no expense for that" (R. 2467, 2512-3, 204). Petitioner has paid no part of the costs and expenses, the amount thereof being included in the judgment in the present case (R. 2474, 2553).

It was agreed at that time that all sales of the stock should be made 25% for the account of petitioner and 75% for the account of respondent (R. 204, 206). Subsequently, in April, 1937, this agreement was reduced to writing and expressed in a promissory note and memorandum attached thereto (Exs. 280 A and B, 224 A and B; R. 2196-7; 2162-3; 551; 405, 2519).

In June, 1936, the Collector presented the stock certificates for transfer and new certificates were issued, of which 25% were registered in the name of petitioner and 75% in the name of respondent. All the new certificates were immediately endorsed by the registered owners and returned to the Commissioner, who continued to hold them until the public offering of Bath Corporation stock was undertaken (R. 2467-8, 2513).

Petitioner and one Allen Melhado carried on negotiations for marketing Bath Corporation stock, and in the summer of 1936, an arrangement with respect to marketing the stock was made with a group of underwriters headed by Hemphill Noyes & Co. The arrangement called for a public offering of 194,000 shares of which 50,000 shares represented a new issue by Bath Corporation and 144,000 shares represented outstanding stock, one-half of which, or 72,000 shares, was to be made available under option from the stock owned by petitioner and respondent.

Respondent took no part in the negotiations which were carried on with the prospective underwriters (R. 1029-30; 2468, 813-4; 1274, 683, 1025, 1925). The petitioner kept respondent and other stockholders of Bath Corporation advised concerning the progress of the negotiations.

The agreement between petitioner and respondent contemplated that sales of Bath Corporation stock should be in a 75%-25% proportion.

After the tentative arrangement with the prospective underwriters petitioner told respondent that "I am the optionee and cannot sell any of my stock because under the laws of the S.E.C. you cannot do that" (R. 2469-70). This statement was not correct (R. 2514, 2592). Petitioner said that respondent would have to sell 18,000 shares of stock, that being 25% of the shares which were to be offered from the stock owned by petitioner and respondent together, for the account of petitioner, and that petitioner would "reimburse" to respondent the shares sold for petitioner's account (R. 210). Petitioner also told respondent and the other stockholders that he was to receive half of the underwriting profits, after certain deductions, and that this would be divided among the stockholders who sold their stock so that they would receive an additional $2 or $3 per share for the shares which were taken by the underwriters (R. 210-1; 1852, 2486-7).

A registration statement to be executed and filed by the Bath Corporation covering the public offering was prepared

by attorneys for the underwriters, and respondent took no part in its preparation, except to sign a written statement which correctly set forth his total holdings of Bath Corporation stock (D's. Ex. 97, R. 2423-5; 1979).

The registration statement correctly disclosed that respondent had given an option upon 72,000 shares of stock and that other stockholders had also given options upon 72,000 additional shares of stock. It disclosed that petitioner and respondent were associates in various business enterprises and it showed the exact amount which was to be paid by the underwriters for the stock which they purchased and the exact amount for which the stock was to be resold to the public (D's Exs. 27 and 28, R. 2334-61; 692). Petitioner claims that the registration statement was deficient because it failed to show that 25% of the stock optioned by respondent was for the account of petitioner and that petitioner had agreed to divide his part of the underwriting profits with the respondent. Respondent made no representation to the registrant, underwriters or experts who prepared the statement, concerning these matters, nor was he a party to nor did he sign the registration statement. Petitioner, on the other hand, confirmed in writing to the registrant and the underwriters the correctness of the statements in the registration statement concerning such matters (Ex. 250, R. 2169, 481).

The Collector of Internal Revenue, in accordance with instructions from petitioner and respondent, deposited certificates representing 72,000 shares of stock registered in the name of respondent for delivery upon exercise of the option to the underwriters, and deposited the balance of the certificates, registered in the names of petitioner and respondent, in escrow with the principal underwriter, and the receipts issued by the principal underwriter for this deposit were endorsed by petitioner and respondent, respectively, and returned to the Collector of Internal Revenue (Exs. 248 and 249, R. 2168, 481). Later, petitioner and respondent assigned a part of the shares held by the prin-

cipal underwriter to the Bank of Manhattan as security for a joint loan, and upon termination of the escrow agreement, the shares so assigned were delivered to the Bank of Manhattan, where they were held at the time of the commencement of this suit. Subsequently, the Bank of Manhattan, pursuant to stipulation and order, deposited these certificates with the Clerk of the District Court, in which the suit was pending (R. 97 to 102).

All of the optioned stock was taken down by the underwriters and sold.

Summary of Argument

1. There is no question of federal law involved in the decision of this case.

2. The decision in this case is based upon findings of fact having no connection with the Securities Act of 1933 as follows:

(a) The fiduciary nature of petitioner's relation to respondent;

(b) The lack of any participation by respondent in the alleged illegality;

(c) The alleged illegal scheme was conceived by petitioner, and respondent agreed to the plan suggested by petitioner upon petitioner's false representation that a different method of accomplishing the same result would be illegal;

(d) Respondent was not in *pari delicto* with petitioner who had charge of arranging the underwriting and upon whom petitioner relied;

(e) The contracts between petitioner and respondent were legal, valid and binding;

(f) There was no agreement that the contractual relationship should be used in an improper manner and petitioner had no knowledge of any intended improper use and no motive to concur therein;

(g) The alleged improper acts (the omission to mention provisions of the contractual relationship in the registration statement) were remote in point of time and only indirectly connected with the contracts themselves;

(h) The alleged illegality was a thing of the past which was collateral to the cause of action asserted upon the valid contracts;

(i) The subject matter of the suit was held in escrow under what is in effect an order of interpleader so that a refusal to enforce the agreement in favor of respondent would amount to granting affirmative relief in favor of the other party who was alone responsible for the asserted illegality.

3. The decision of the Circuit Court of Appeals on the law applicable to the foregoing facts is entirely in accordance with the local decisions, as well as the decisions of the federal courts.

4. If there were a violation of the Securities Act of 1933 involved in the determination of this case, the decision would not be in conflict with the decision of the Circuit Court of Appeals of any other circuit, nor of this Court, but would be entirely in accord with the decision of this Court in *A. C. Frost & Co.* v. *Coeur d'Alene Mines Corp.*, 312 U. S. 38.

ARGUMENT

No Question of Federal Law

The Circuit Court of Appeals properly rejected petitioner's claim that respondent could not enforce the agreement in suit with his confidential adviser because it was tainted with illegality. The asserted illegality consisted of the failure of a registration statement filed by the Bath Corporation under the Securities Act of 1933 to disclose certain information of doubtful materiality.

The evidence disclosed a close relationship between the parties to the contract extending over a long period of time. It appeared that the confidential adviser, petitioner, had carried on all negotiations for marketing the stock and had proposed the form in which the deal should be cast to carry out a prior agreement for division of the profits from the stock. When suit was started, the particular shares of stock

claimed by respondent and other stocks were held by the Bank of Manhattan as collateral to a joint note of petitioner and respondent and prior to trial all of these securities were deposited with the Clerk of the District Court under what was in effect an order of interpleader (R. 97 to 102).

This is not a case where rights are claimed under the Securities Act of 1933. Petitioner is not a member of the class intended to be protected by that Act. This case in no way involves any of the administrative duties of the Commission under the Securities Act of 1933. The Act requires disclosure in a specified manner of *material* information concerning securities which are offered to the public. The present case presents no question concerning the interpretation or application of any of the requirements of the Act. The most that can be said is that it *might* have been necessary to determine whether the information omitted from the registration statement was material, but as will be pointed out hereafter, the Circuit Court of Appeals did not find it necessary to decide that question.

Petitioner has not denied the existence of his confidential relationship with respondent and the nature and extent of this relationship is clearly shown by the testimony (see *supra,* p. 3). The lower courts have concurred in finding that the disputed contract was made at the suggestion of petitioner because of his false representation that a different procedure would be illegal (R. 2469-70, 2514, 2542). It is undisputed that respondent was not told that the procedure suggested by petitioner was illegal in any way (R. 1925). It is conceded that respondent was not a party to nor signatory of the registration statement which is alleged to be deficient. Petitioner himself testified that respondent had no contact with the underwriters or experts preparing the registration statement until a day or two before the statement was filed (R. 683, 1026, 2484) and petitioner further testified that the underwriters, one Allen Melhado and petitioner were the only ones who had anything to do with the negotiations for the sale of the stock (R. 1025). It appears

from undisputed documentary evidence (Ex. 250, R. 2169, 481) that petitioner himself confirmed the information set forth in the registration statement which he now alleges was incorrect.

The lower courts have concurred in their findings and conclusions that the contract here involved is legal, valid and enforcible (R. 2512, 2514, 2519, 2542, 2592-3). It was further found by the lower courts that the underlying agreement concerning the Bath Corporation stock between these parties was made months before this particular underwriting arrangement was contemplated (R. 2467).

Petitioner does not contend that the particular agreement shown by the testimony was illegal. He claims that the agreement was improperly conceived and used so as to conceal his interest in 18,000 shares of stock which were sold to the underwriters. The agreement was conceived by petitioner (R. 2591-2; 2469-70) and respondent made no use of it. If it was used as a means of concealing any fact from the underwriters, or from the experts, or from the public, that use was conceived and carried out by petitioner. Petitioner had undertaken to make all of the arrangements for the marketing of the stock (R. 2467) and he performed that undertaking. He now claims that it was performed in such a manner by him as to prevent respondent from enforcing the very agreement under which petitioner acquired his only interest in the stock or the profits therefrom.

No Participation by Respondent

Petitioner has attempted to connect respondent with the alleged illegality by referring to a finding or conclusion of the District Court, rejected by the Circuit Court of Appeals, that the purpose of the agreement was to conceal petitioner's interest in the sale of the stock (R. 2542). The District Court stated that the methods and reasons for the agreement were discussed by the parties (R. 2544), but the only discussion shown by the evidence was petitioner's

false statement that he couldn't sell any of his own stock "because under the laws of the S E C you cannot do that" (R. 210, 2469). There was no mention at any time of disclosure or concealment. Certainly respondent's purpose was not to conceal the agreement because it is obvious that he had no knowledge concerning what disclosures, if any, were required in a registration statement (R. 367). Certainly, as pointed out by the Circuit Court of Appeals (R. 2593, 2594), respondent had nothing to gain from any such omission from the registration statement and no motive to conceal the information which was omitted therefrom. There was no agreement for concealment, no discussion of concealment, no motive for concealment and no knowledge that disclosure was required.

There is no support in the record for the inference by the District Court that the agreement was made for an improper purpose. That inference was based apparently upon the simple fact that the agreement was made. It was properly rejected by the Circuit Court of Appeals. Certainly where parties have a perfectly valid agreement to divide the profits from a transaction, it cannot be inferred that they have adopted an illegal method of effecting such division from the fact that they enter into another valid agreement concerning the procedure which would be followed. The inference of an improper purpose and motive which was made by the District Court and which is so strongly relied upon by petitioner, cannot be supported. *Pa. R. R. Co.* v. *Chamberlain* (1933) 288 U. S. 333, at 339; *Fidelity & Deposit Co.* v. *Grand National Bank of St. Louis* (C. C. A. 8th, 1934) 69 F. (2d) 177. In the latter case the court said at page 183:

> "There is a presumption not only of innocence, but of good faith. There is a presumption that business is conducted lawfully, Missouri Pacific R. Co. *v.* Prude, 265 U. S. 99, 44 S. Ct. 450, 68 L. Ed. 919, and that all things are rightly done, Chesapeake & O. R. Co. *v.* De Atley, 241 U. S. 310, 36 S. Ct. 564, 60 L. Ed.

> 1016; and where the act of a party may be referred indifferently to one of two motives, the law prefers to refer it to that which is honest, rather than to that which is dishonest, Alexander *v.* Fidelity Trust Co. (C. C. A. 3) 249 F. 1. As said by this court in American Surety Co. *v.* Citizens' Natl. Bank (C. C. A. 8) 294 F. 609, 616: 'Until there be reasonable ground to think otherwise, a presumption prevails that one acts honestly and keeps within the requirements of the law.' "

It is entirely clear upon this record that the purpose of the agreement that respondent should option 18,000 shares of stock for the petitioner was to carry out the prior agreement of March 1936, that the profits from the stock would be divided between them on the basis of 25% to petitioner and 75% to respondent. In determining the method to be followed, respondent, an industrialist, gave no consideration to any requirements of the Securities Act of 1933, but relied upon petitioner, an experienced lawyer, to see that the arrangements for marketing the stock were made in a proper manner.

Petitioner attempts to attribute a sinister purpose to the 18,000 share arrangement by referring to it as "secret". There was nothing secret about it. Both petitioner and respondent discussed its exact terms with at least six of the witnesses in this case, including two government agents (R. 452-3, 402-7, 430, 486-7, 1988, 552-4) and petitioner wrote a letter to one of the government agents in which he stated exactly what was being done (Ex. 325, R. 2251, 1314).

Fiduciary Relationship

We have here a case of a person owning stock who is about to sell a part of his holdings to underwriters for public distribution, and recognizing his own lack of knowledge, entrusts all of the details to one in whom he reposes trust and confidence and whom he believes to be competent

and experienced. The Circuit Court of Appeals properly recognized and gave effect to this situation. That court said:

> "It is to be remembered that Buckley was a lawyer of experience upon whom Judson would evidently rely (and he testified that he did rely) in such a complex matter as a registration statement. Buckley told Judson that it was necessary to cast the transaction in the form adopted in order to comply with the law. Judson accepted Buckley's plan, yet even as late as January, 1937, he wrote to his tax counsel indicating that he did not understand the necessity for it (Defendant's Exhibit 86).
>
> "In view of the circumstances of the present case, it seems to us that Judson was in the position of a person having nothing to gain by any errors in the registration statement, and that so far as he had any share in them, he had it because of the guidance of Buckley, who was his agent and confidential adviser" (R. 2594).

Under these circumstances, where the alleged illegality is not the commission of a heinous crime, it would create an anomalous situation to sustain the agent's plea that he had misrepresented his client or mishandled the matter entrusted to him and thus bar the principal's enforcement against the agent of a perfectly lawful agreement. It has been held in numerous cases that such a plea by a confidential agent or fiduciary cannot be sustained.

Ford v. *Harrington* (1857) 16 N. Y. 285;
Tracy v. *Talmadge* (1856) 14 N. Y. 162;
Norton v. *Blinn* (1883) 39 Ohio St. 145;
Place v. *Hayward* (1889) 117 N. Y. 487;
Brooks v. *Martin* (1863) 2 Wall. 70;
Planters' Bank v. *Union Bank* (1872) 16 Wall. 483, 499;
Ingersoll v. *Weld* (1905) 103 App. Div. (N. Y.) 554;
Duval v. *Wellman* (1891) 124 N. Y. 156;
Wood v. *Rabe* (1884) 96 N. Y. 414.

See also—

Kinsman v. *Parkhurst* (1855) 59 U. S. 289, 293; 18 How. 289, 293;
Steele v. *Drummond* (1927) 275 U. S. 199;
Van Tines v. *Hilands* (S. D. N. Y. 1904) 131 Fed. 124;
Twin City Co. v. *Harding Glass Co.* (1931) 283 U. S. 353, 356.

Neither the petition for writ of certiorari nor the brief in support thereof points out anything that respondent should have done or could have done to correct the registration statement if any correction were needed. As previously stated, respondent was not called upon to give any information to those who prepared the registration statement except to make a disclosure concerning the amount of stock which he owned and that disclosure was correct and accurate (D's. Ex. 97; R. 2423-5, 1979). The only suggestion that some further act of Judson's would have corrected a deficiency is contained in the opinion of the Circuit Court of Appeals where it is said

> "It does appear that at this point [January, 1937, more than three months after the filing of the original registration statement] Judson realized that the registration statement did not properly state the number of shares he and Buckley were selling and he took no steps to have it amended" (R. 2593).

The record shows, however, that respondent discussed the question of amendment with petitioner and left the disposition thereof to petitioner. Petitioner testified that he discussed the matter with the attorney for the underwriters who objected to any amendment because the 50,000 shares of stock sold by the Bath Corporation had already been sold and paid for (R. 696-7).

The Alleged Illegality is Collateral and Remote

The stock which respondent was awarded was not sold to the underwriters nor distributed to the public. Respondent recovered shares which were registered in the name of petitioner before any agreement was made for optioning any stock for petitioner's account. Respondent is entitled to the shares which were awarded to him under his agreement with petitioner of March, 1936. In order to carry out that agreement, as stated by the Circuit Court of Appeals,

> "it was practically necessary to sell the shares of stock, from whatever block derived, for the account of each (petitioner and respondent) in proportion to his interest in the proceeds. Otherwise, it would have been open to either of these men who, as coadventurers, owed each other reciprocal obligations to deal in good faith, to take an unconscionable advantage of the other" (R. 2595-6).

The alleged illegality in connection with the marketing of the stock would not bar enforcement by respondent of his valid contract with petitioner.

Brooks v. *Martin* (1863) 2 Wall 70;
Planters' Bank v. *Union Bank* (1872) 16 Wall 483, 499;
Langley v. *Devlin* (1917) 95 Wash. 171;
Tracy v. *Talmadge* (1856) 14 N. Y. 162;
Hanover Natl. Bank v. *First Natl. Bank* (C. C. A. 8th, 1901) 109 Fed. 421;
State v. *Capital City Bank,* (1927) 32 N. M. 369.

The policy of the law which imposes reciprocal duties upon those in the relationship of the parties to this suit is illustrated by *Meinhard* v. *Salmon* (1928) 249 N. Y. 458.

Petitioner is Not Entitled to Affimative Relief

Petitioner here contends that respondent should not be permitted to enforce a contract because of an alleged illegality. But if respondent is denied enforcement and petitioner is awarded the stock in the custody of the court, the petitioner would in effect receive affirmative relief. He would receive shares of stock for which he has never paid and which have never been in his possession except for the moment required to endorse the certificates and pass them back to the possession of the Collector of Internal Revenue.

When petitioner suggested that the agreement for division of the profits be expressed by giving him an interest in the stock, he agreed that the stock should be held by respondent or in respondent's account until his share of the purchase price had been paid (R. 2512-3, 2570). This was subsequently expressed in the written note and memorandum (Ex. 280 A & B, R. 2196-7; 551) by which respondent was given a lien upon all the Bath Corporation stock in which petitioner had an interest as security for all of petitioner's indebtedness to respondent. Respondent's right to possession of these securities has at all times been superior to the right of petitioner. Their respective rights to possession were subject to various prior liens at the time this suit was instituted, but when those liens were discharged, petitioner's right was subject to the lien of respondent and that lien has never been discharged. The lower courts so held.

The lower courts were called upon to determine the right to possession and if a decree had been entered awarding this possesion to petitioner, he would have obtained enforcement of respondent's agreement to transfer 25% of the securities purchased to him. The law is well settled that a defendant claiming illegality cannot himself secure affirmative relief and it is well stated in *Buchhalter* v. *Rude* (C. C. A. 10th, 1931) 54 F. (2d) 834, modified as to costs 286 U. S. 451, cited in the opinion of the Circuit Court of Appeals, that where the court must determine as between

two wrongdoers which should have possession of securities in the hands of a third party, the award will be made without taking into consideration the wrongful act in which they both participated. See also *Langley* v. *Devlin* (1917) 95 Wash. 171.

The Decision of the Circuit Court of Appeals Is In Accord with Applicable Law

The decision in the Circuit Court of Appeals was not based upon any interpretation of the Securities Act of 1933 and was not dependent upon the materiality of any omissions from the registration statment filed under that Act. But even if it were conceded for the purpose of argument, contrary to all the facts shown by this record, that there was a violation of the Securities Act of 1933 in which respondent knowingly participated, the result which was reached by the Circuit Court of Appeals—enforcement of the contract between petitioner and respondent—would be in accord with the decision of this Court in the case of *A. C. Frost & Co.* v. *Coeur d'Alene Mines Corp.*, 312 U. S. 38.

The materiality to prospective investors of the information which was omitted from the registration statement was not determined by the Circuit Court of Appeals, though that court quite properly commented upon the relative unimportance of the omitted information. Certainly it is difficult to see how the errors complained of "could mislead prospective purchasers as to the value of the stock or really prejudice them in any way" (R. 2593). Further, "Disclosure that Judson was to share in the underwriting profits would, if anything, have given the impression that the shares were more valuable than one might have supposed from the $6 sale price * * *" (R. 2593). Obviously, a disclosure that petitioner was participating in the sale of stock to the underwriters would have added very little to the disclosures actually made that the holders of more than 87% of the outstanding shares, including all of the officers of the Company, were participating in the sale and that

petitioner and respondent were associated in various business enterprises (R. 2349, 2354-5, 2334).

There was no finding either by the Special Master or by the District Court that the omitted information was material in any way. Yet each denied enforcement of the contract because certain information was omitted from the registration statement, although non-disclosure of facts is of no consequence under the Securities Act of 1933 unless the omissions are "material". It does not appear that either the Special Master or the District Court considered that limitation, but it is entirely clear that the Circuit Court of Appeals granted enforcement of the contract regardless of any question of materiality.

Petitioner attempts to distinguish the *Frost* case on the ground that the violation of the Securities Act involved therein was comparatively slight. The violation in that case consisted of the knowing failure to file any registration statement at all. In the instant case the claimed defect in the registration statement, which correctly set forth the stock holdings of both respondent and petitioner and the number of shares optioned by respondent, would have been entirely eliminated if there had been included a reference to the agreement between them with respect to the 18,000 shares of stock.

Furthermore, in the *Frost* case this Court allowed an underwriter to recover damages from an issuer. Both parties were directly concerned in the public offering of the stock. Although they had knowingly failed to file any registration statement, the underwriter recovered damages from the issuer for breach of contract.

In the *Frost* case this Court decided that it was not the intention of Congress to impose in the Securities Act of 1933, in addition to the express penalties there set forth, the added sanction that contracts involving a violation of the statute should be void. The Securities Act became law in 1933 and has been amended since that time in various particulars, but no amendment has added any such pro-

vision. Petitioner urges that this Court erred in the *Frost* case, but it is submitted that its decision was clearly correct in not imposing a sanction which Congress itself had failed to include in the Act.

In the *Frost* case, this Court quoted with approval from *Twin City Co.* v. *Harding Glass Co.*, 283 U. S. 353, at 356-7, that the rule that contracts in contravention of public policy are not enforcible

> " 'should be applied with caution and only in cases plainly within the reasons on which that doctrine rests. It is only because of the dominant public interest that one who, like respondent, has had the benefit of performance by the other party will be permitted to avoid his own promise.' "

The contract herein which was enforced in favor of respondent did not violate the Securities Act of 1933 nor any rule or regulation thereunder, as found in the lower courts (R. 2519, 2514, 2592-3), and the performance of that contract did not require any such violation. Respondent is not responsible in any manner for any violation of the Act which may have occurred and it is extremely doubtful that the information omitted from the registration statement did violate the Act. But even if there were a violation, the contract would be enforcible on the authority of *A. C. Frost & Co.* v. *Coeur d' Alene Mines Corp., supra.*

Conclusion

There is no important public question involved in this case. There is no conflict between the decision of the Circuit Court of Appeals and the decision of a similar question by the court in any other circuit, nor by this Court. The question actually decided by the Circuit Court of Appeals in the present case was the effect of a particular relationship between the parties upon the respondent's right to enforce a contract not referred to in a registration state-

ment, where the subject matter of the suit was under the control of the court, so that affirmative relief had to be given to one of the parties and where the alleged illegality was past and remote. The petition for writ of certiorari should be denied.

Respectfully submitted,

ELI WHITNEY DEBEVOISE,
Counsel for Respondent.

DEBEVOISE, STEVENSON, PLIMPTON & PAGE,
D. F. MCGLINCHEY,
Of Counsel.